

DEPARTMENT OF AGRICULTURE  
Rural Electrification Administration

Administrative Memorandum

Subject: Organization and Basic Procedure for Ascertaining the  
Need, Nature and Extent of a Retail Rate Revision

In conformity with REA policy of making available to borrowers the guidance and assistance of its staff of specialists, and in conformity with REA rate policy, the following organization and procedure are established to guide the REA staff in ascertaining the need, nature and extent of a retail rate revision.

SECTION A - ORGANIZATION

Discovering the Possible Need of a Retail Rate Revision

The Chief of the Management Division shall arrange an intra-divisional procedure whereby, in the course of current analyses and evaluations of the financial status of cooperatives, special attention shall be given to detection of the possible need of a revision of a cooperative's retail rate structure and schedule. Any indicated possible need of revision shall be referred by the Chief of the Management Division to the appropriate Regional Retail Rate Committee for intensive study. This emphasis of the continuing responsibility of the Management Division does not diminish the responsibility of the Applications and Loans Division to make similar references to appropriate Regional Rate Committees when need of revision is indicated in the course of studies of feasibility of new loans for extension of existing systems.

Regional Retail Rate Committees

There is hereby established for each region a Regional Retail Rate Committee for intensive study of the need, nature and extent of indicated rate revision. It shall be constituted as follows the Regional Head of the Applications and Loans Division, the Regional Head of the Management Division, and a representative of the office of the Rate Specialist Management Division, designated by the Rate Specialist. This representative designated by the Rate Specialist shall serve as chairman. The rate engineer in the regional office of the Management Division shall serve as technical assistant to the Regional Retail Rate Committee, and the regional heads in the Engineering Division and in the Finance Division shall as requested serve in an advisory capacity.





Direction and Coordination of the Work of Regional Retail Rate  
Committees

The Rate Specialist of the Management Division shall be responsible for over-all direction and coordination of the work of all Regional Retail Committees, which shall be conducted in accordance with the procedures in Section B.

Retail Rate Review Committee

There is hereby established a Retail Rate Review Committee consisting of the Chief of Applications and Loans Division and the Chief of Management Division, the latter serving as chairman. To this Retail Rate Review Committee the Regional Retail Rate Committees shall report all rate studies, including in respect of each borrower the findings of fact, conclusions, whether recommendations are for or against revision; and any recommendation for revision shall be accompanied by a proposed new rate structure and schedule. After review of each report concerning a borrower the Rate Review Committee shall submit its recommendations, accompanied by the report of the Regional Retail Rate Committee, to the Administrator for final consideration.'

SECTION B - BASIC PROCEDURE

As technical assistant for a Regional Retail Rate Committee, the rate engineer in the office of the Regional Head Management Division shall, under the immediate direction of the latter ultimate direction of the Rate Specialist, assemble, analyze and summarize all pertinent data, make preliminary calculations, and report his findings and recommendations to the Regional Retail Rate Committee. In case of a recommended rate revision he shall formulate a suggestive plan of revision for consideration by the Regional Retail Rate Committee. These analyses and calculations shall be by the following steps:

STEP 1. ASSEMBLY OF BASIC DATA, including--

1. Pertinent Monthly Financial and Statistical Reports and available Operating Audit Reports.
2. Consumption Analysis Report (Form CO-74, July 1944).
3. Report, by schedules, of revenue received and KWH sold (supplementing Monthly Energy Sales at top of page 2 of Monthly Reports).
4. Basic estimates from Applications and Loans Division concerning the optimum development of the system (approximate completion of area coverage by construction of main structure of the system), as follows:
  - a. Miles of lines
  - b. Total investment
  - c. Number of consumers by classes
  - d. Average KWH usage per consumer by classes





**STEP II. FINANCIAL ANALYSIS OF MOST RECENT YEARLY ACCOUNTING PERIOD**

as indicated by Monthly Financial and Statistical Reports and available Operations Audit Reports for the purpose of discovering whether there are revenues in excess of expenses presumably available for rate reductions.

From: Operating Revenues (Sec. B, Line 1)

Subtract: The sum of the following--

Operating Expenses (Sec. B, Line 2)  
Depreciation at the rate of 3.48 percent  
of distribution plant value (Sec. B, Line 3)  
Amortization of Intangibles, etc.  
(Sec. B, Line 4)  
Taxes (Sec. B, Line 5)  
Interest (Sec. B, Line 12)  
Interest Charged to Construction  
(Sec. B, Line 13)  
Miscellaneous Income Deductions  
(Sec. B, Line 14)  
Principal Due and Payable  
(Sec. C, Line 2)  
Additions to reserves (as determined by  
Administrative Policy Advisory Committee)

It should be noted that the indicated analysis is of the actual accounts of a going concern, which are on an accrual basis. The purpose is to ascertain

- (1) net income before reservations (without inclusion of income from merchandising and other non-operating activities) as shown by the monthly operating reports, and
- (2) the cash requirements for necessary reserves and for principal due and payable..

It should be noted further that, because the accounts are on an accrual basis, depreciation as shown on the reports is a valuation charge only, and does not necessarily have a direct relation to cash requirements for replacements to maintain the system in condition to render dependable service. One percent of distribution plant value is considered an adequate cash requirement to meet replacement needs. Therefore, an adjustment must be made in view of the fact that the depreciation charge in the accounts represents 3.48 percent of distribution plant value in contrast to the 1 percent cash requirements assumed to be adequate. This adjustment may be made in either of two ways: by





adding 2.48 percent of distribution plant value to net income before reservations as derived from the reports, or subtracting a like amount from aggregate requirements for reserves and principal due and payable.

The balance shown by the above subtraction should be appraised in the light of the cumulative balance sheet surplus or deficit as affected by depreciation from date of energization.

#### STEP III. FINANCIAL ANALYSIS OF AN IMMEDIATE FUTURE PERIOD

Following the above analysis, there should be made an identical analysis at existing rates of a hypothetical year three to five years later (for instance, after some critical point is reached such as maximum schedule of principal payments) based on estimated trends of revenue and expense. Data for estimation of the trends and their results should be available in the office of the regional head of Management Division and in the office of the regional head of the Applications and Loans Division. These data should include all items of which the following are illustrative: possible change of terms of the loan; possible rephasing and other reconstruction; possible extensions; possible loss of large consumers (special war uses, a saw mill exhausting its timber, etc.); possible intensive utilization program.

#### STEP IV. FINANCIAL ANALYSIS AS OF OPTIMUM DEVELOPMENT

A third identical analysis at existing rates should then be made of a hypothetical year when optimum development of the basic structure of the cooperative's system has been achieved. The characteristics of this hypothetical optimum year should be derived from development data provided by the Applications and Loans Division, supplemented by experience and trend data provided by the Management Division, and all types of data noted in connection with Step III should be considered evaluated.

#### STEP V. RATE REVISION ESTIMATES

The financial analyses of hypothetical conditions in Steps III and IV have applied the existing rates, and have resulted in different annual surpluses as adjusted. The next step is to design a rate that will eliminate the surplus under that one of the two hypothetical conditions which yields the lesser surplus. There will, of course, remain a surplus under the other hypothetical condition. Presumably this rate that eliminates the lesser surplus is approximately the new rate indicated, but there should be a careful review of all assumed conditions.

In the design of new rates the structure generally employed by the industry and heretofore recommended by REA shall be used,







Namely; a structure involving a minimum bill, KWH rate blocks, and in appropriate cases charges based on demand; all intended to promote use by a diminishing cost per KWH as larger quantities are used.

#### SECTION C - MISCELLANEOUS GUIDING ITEMS

1. Judgment reflecting diversified experience must play a large part in all calculations involving hypothetical situations.
2. Reserves are built up by annual contributions, or by annual additions and withdrawals, and generally have a ceiling determined by law or policy which eventually is reached. This should be taken into consideration in calculating reserve contribution requirements of future situations. In all calculations concerning the future every potential item of the types noticed in connection with Step III should be considered and evaluated.
3. In view of the allowances for reserves (depending, of course, on what these are in particular instances) and for depreciation as adjusted, no further margin of safety appears necessary, but it is better to design a rate that yields a plus rather than a minus degree of surplus.
4. Except for special reductions for particular purposes (such as minimum bills to eliminate inequalities in adjacent schedules or for some other special purpose), it is not advisable to recommend a small reduction in a general rate schedule--for instance amounting to less than five percent of gross revenue.
5. Occasional rational experiments in connection with rates may be considered--such as separating on consumers' bills the cost of energy and the contribution to capital, or "vernier adjustments" through monthly or quarterly discounts, or more fundamental arrangements--but any departure from existing forms of rate structure or the introduction of special devices should in each instance be referred to the Administrator for approval.

*Claude R. Wickard*

CLAUDE R. WICKARD  
Administrator

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However, a structure involving a minimum bill, 50% rate floor, and in appropriate cases changes based on demand, all intended to provide use by a disincentive cost per kWh or larger quantities are used.

SECTION 3 - RECOMMENDATIONS CONCERNING THE

1. Judgment reflecting diverging experience must play a large part in all calculations involving hypothetical situations.
2. Reserves are built up by annual contributions, or by annual additions and withdrawals, and generally have a ceiling determined by law or policy which eventually is reached. This ceiling is taken into consideration in calculating reserve contribution requirements of future situations. In all calculations concerning the future every potential item of the type involved in connection with step III should be considered and evaluated.
3. In view of the allowances for reserves (depending, of course, on what these are in particular situations) and for depreciation as adjusted, no further margin of safety appears necessary, but it is better to design a system that yields a plus rather than a minus degree of surplus.
4. Except for special reductions for particular purposes (such as minimum bills to eliminate speculation in adjacent scheduled or for some other special purpose), it is not advisable to make such a small reduction in a general rate schedule-for instance, amounting to less than five percent of gross revenue.
5. Conventional national expenditures in connection with rates may be considered--such as separating on consumers' bills the cost of energy and the contribution to capital, or "variable adjustments" through monthly or quarterly discounts, or more fundamental arrangements--but any departure from existing forms of rate structure on the introduction of special devices should in each instance be referred to the Administrator for approval.

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Administrator

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